DOW THEORY LETTERS INC.

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Mar. 30, DJIA 951.01, PTI 873, A-D ratio -8.68
April 6, DJIA 931.52, PTI 846, A-D ratio -9.63

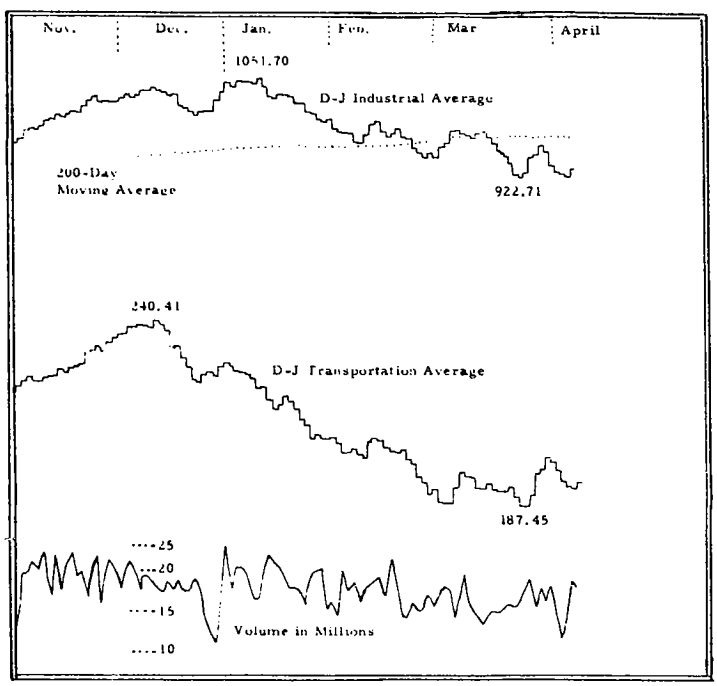
MARKET DIARY: April 3, the Primary Trend Index (PTI) breaks to a new 1973 low. April 4, the Advance-Decline ratio breaks to a new primary bear market low, its lowest level since the mid-1940's! On the same day, the PTI sinks below its 1971 low, thus wiping out the upside technical progress of the past 16 months. At the comparable 1971 (November) low, the Dow Industrial Average stood at 797.97 (see page 2 chart).

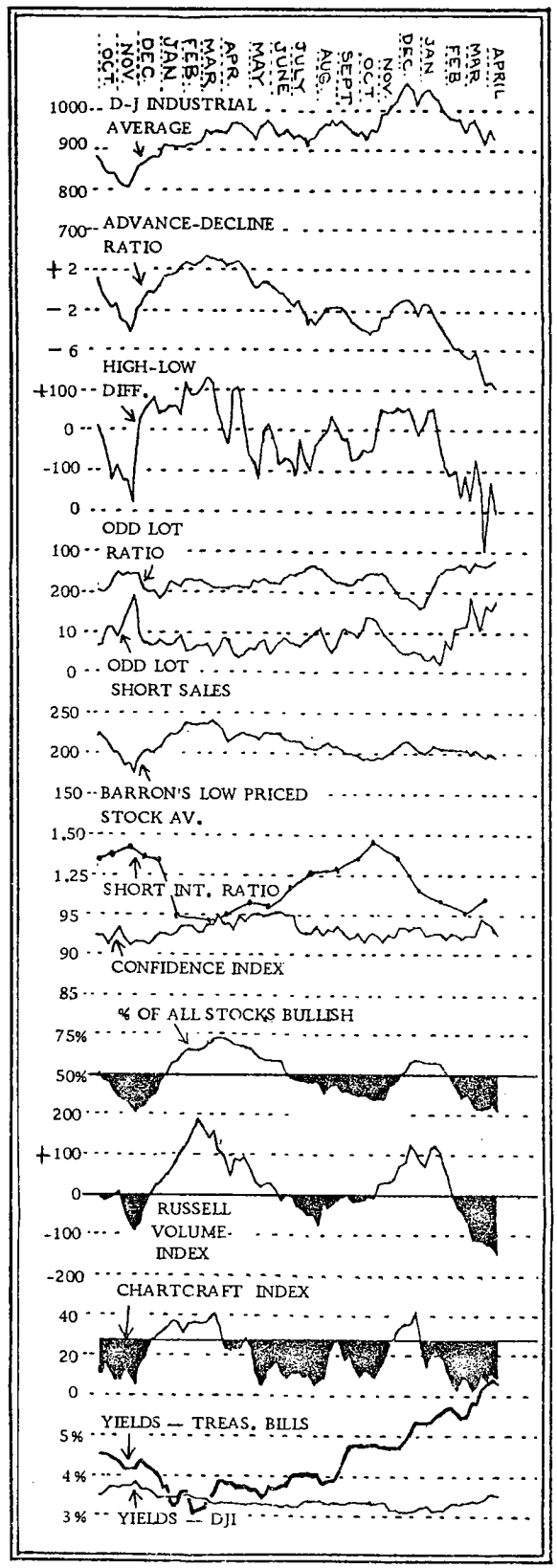
NOTE: Again I recommend that subscribers save previous Letters for reference purposes. Also, I strongly suggest that all subscribers take the three minutes a month it requires to chart the weekly Dow, PTI and A-D ratio figures as shown at the top of page 1 in each of these reports. This will give you an excellent, quick-reference "feel" for the technical position of the market.

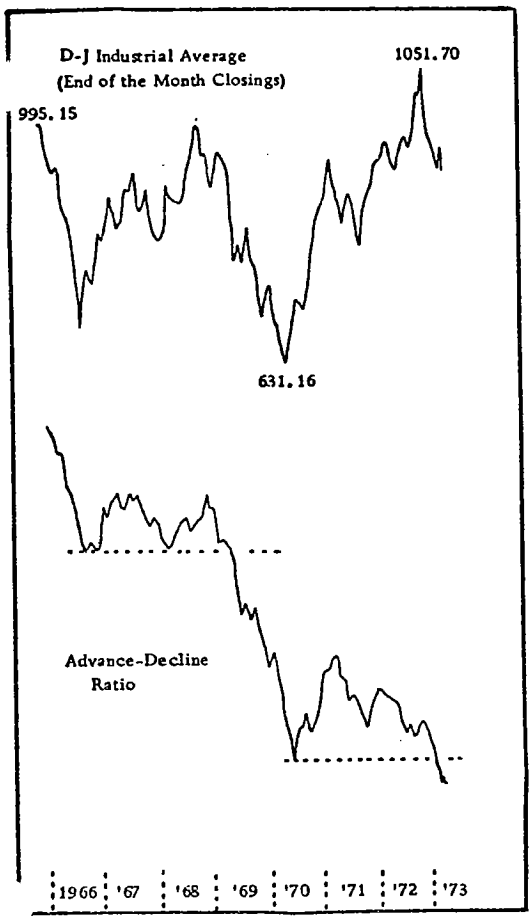
THE MARKET: In a broad sense, market history always repeats. In a narrower sense, no two bull or bear markets are ever the same. I have included no less than three critically important charts in this report, each based on a different method of tabulating and interpreting the number of issues that advance or decline on the NYSE.

In my opinion, the most important and fundamental things a broad "market" can do is (1) rise or fall, based on any or all of the price indices, and (2) rise or fall, based on a plurality of advances or a plurality of declines. The third important thing which a market can do is produce varying amounts of volume, but I agree with the point and figure theorists who opine that volume tends to be a product of price. For instance, I have never seen a major advance that did not ultimately bring in volume, nor a major collapse that did not bring in volume.

There are some very unique developments in the current primary bear market, new factors which I do not feel are fully understood. For instance, ten

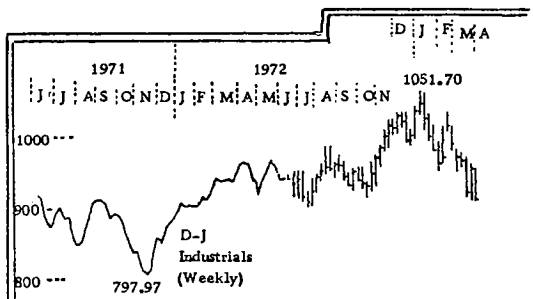




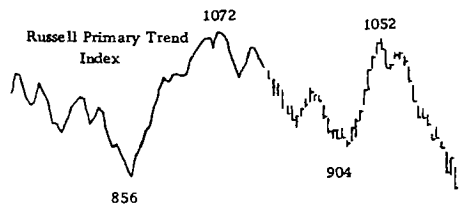


leading banks now control trust assets totaling a staggering $135 billion. A great mass of these securities are concentrated in a small list of big-capitalization stocks: growth, glamour and high-multiple issues. So tight is the concentration that it would be almost impossible for two banks to clear out a single position at anywhere near the same time. In other words, the buying and interest on the part of the big money buyers is very restricted. And the sad fact is that the vast, vast majority of Wall Street's wares have little or no professional or institutional following.

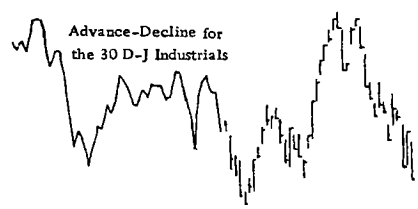
In many ways, what we are seeing is an incredible picture. The NYSE now lists over 2,000 issues. The Amex trades around 1,200 issues per day. The over the counter markets list around 50,000 issues. Over the past decade or so, thousands and thousands of stocks have been distributed to the public, and the public purchased and followed these stocks with great interest. Suddenly, all this has changed. The fact is that public disillusionment has enveloped Wall Street and Main Street. Thousands of issues, countless big, secondary and little companies, are now sinking like so many marbles in the quicksand of mass disinterest. And suddenly it is dawning on Wall Street that only an excited, equity-hungry public can begin to support the countless corporate stocks that have flooded the markets for the past ten to fifteen years.



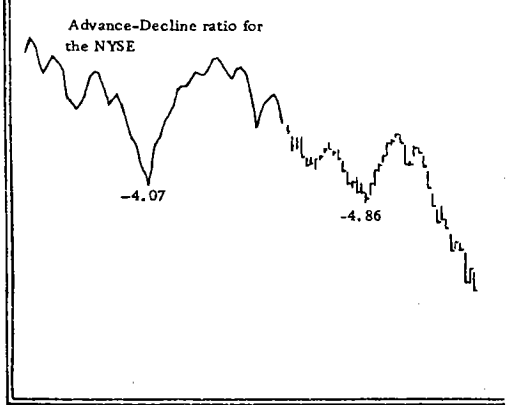
I have been warning (ever since 1966) that the public is slowly but surely moving towards the exits of Wall Street. At first there was the disappointment on the part of the public regarding their own ability to pick "the right stock." Following the 1966 sell-off, the market rallied, and the public moved away from their own selections but into mutual funds. The day of the "gunslinger" had arrived, the day of the "pro" who could double your money yearly while picking only winners. The 1969-70 smash ended that fantasy; the dream of the gunslinger ended as quickly as it had begun. Many of the funds fared badly during 1969-70, others literally collapsed.



When the rubble of 1969-70 had been cleared away, the public was seen to be interested in another major avenue — the avenue out of common stocks. The first chart on this page records the public's exit rather dramatically. This chart pictures the closings of the D-J Industrials and the monthly closing of the daily A-D ratio. It is evident from this chart that while the institutions and trusts were accumulating or supporting a selected list of blue-chips and high-multiple growth stocks, the majority of NYSE issues were heading south.



The year 1972 produced a new kind of retreat on the part of the public, a retreat out of the mutual funds themselves. The era of the "great cash-in" was upon us, and it continues (via heavy redemptions over purchases) to this day. So much for 1972.



So far, the current year 1973 has produced a number of interesting phenomena. First, it opened up with a sliding market, and the first quarter was a disaster. Second, the year 1973 began with NYSE margin debt at a near-record high of $7.9 billion. Thus, Wall Street now finds itself in the exotic position of watching the public sell mutual funds, watching them sell their odd lots, watching them sell individual stocks, and seeing thousands of issues sink (seemingly

regardless of earnings or P/E ratios).

How can all this be happening? How can countless stocks hit new lows in the face of booming business conditions, optimism on the part of leading economists and during a period of blazing inflation? How can stocks continue to slide while the market is terribly oversold?

I will repeat again that no two bull markets or bear markets are exactly alike. True, this market is very oversold (as seen in the overbought-oversold study in this Letter). The market has been oversold since early February. And perhaps this market is fated to remain in an oversold condition throughout much of 1973, I don't know, but I do know that Wall Street has never seen a situation wherein 31 million stockholders were discouraged and moving to swap their stock certificates for cash, commodities, bonds, rare coins, bank accounts or simply the expenses of daily living.

The public came back following the first (1966) bear market smash; they came back via the mutual funds. The public has not come back at all following the 1969-70 fiasco. And illiquidity is the spector which is now plaguing the Street. I feel that many time-honored technical and fundamental market theories are fated to go by the wayside before 1973 is out. The sad fact is that most of the analysts are now using the same charts, the same techniques, the same data. There is an old adage which has always applied to Wall Street, "Where everyone is thinking the same, nobody is thinking at all."

Thoughts on illiquidity from the April 3, 1973, issue of Business Week

Illiquidity. The peril is lack of liquidity. In the 1960s, such funds as Mates and Enterprise got trapped with letter stock and shares of companies with floats so tiny that they couldn't unload. By contrast, the banks hold registered shares and stick to companies with giant capitalizations. But many positions are so huge the banks can't get out, except gradually, without collapsing the market. Certainly, several could never bail out simultaneously.

The problem is compounded by dwindling liquidity in the marketplace. Block traders have lost fortunes so far this year and are reluctant to position blocks in inventory. That has put more pressure on specialists to absorb stock. They now have little free capital. Blocks come to market at deep discounts. Without buyers, the market value of banks' big positions may be largely fictional.

The possibility that the high flyers might one day tumble raises prickly questions. Suppose, for example, the assets that 30-million U. S. workers expect to retire on were suddenly cut in half. What might happen to corporate profits if companies—as now required by law—had to make up the difference out of earnings? In that light, perhaps those other stocks selling below 10x aren't so cheap after all.

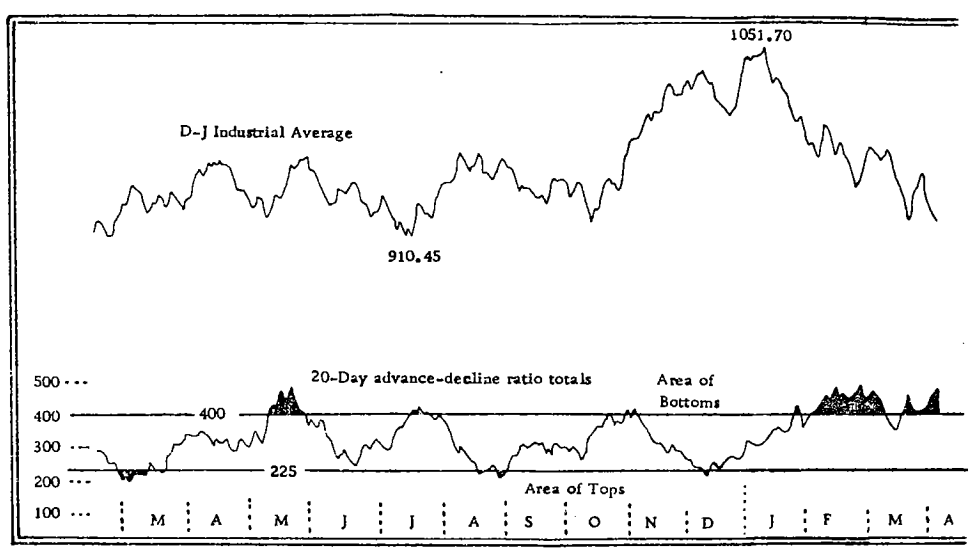
THE OVERBOUGHT-OVERSOLD INDEX (OB-OS Index) study was last seen in Letter 555. Tabulations on the accompanying graph are arrived at as follows: The daily advance-decline ratio figures are added (regardless of whether they are plus or minus) to form a 20-day moving average. This 20-day moving total will tend to oscillate between a high of 500 and a low of 200.

The rational is this: The market acts differently near the extremities of rallies and declines. As a rally approaches its peak the market will "churn." This implies that supply and demand will approach equilibrium. There will be little movement, and the advances and declines will come together, with day after day of little or no movement in the advance-decline ratio. This action will tend to shrink the OB-OS Index down towards 200 or the area of tops as seen on the chart.

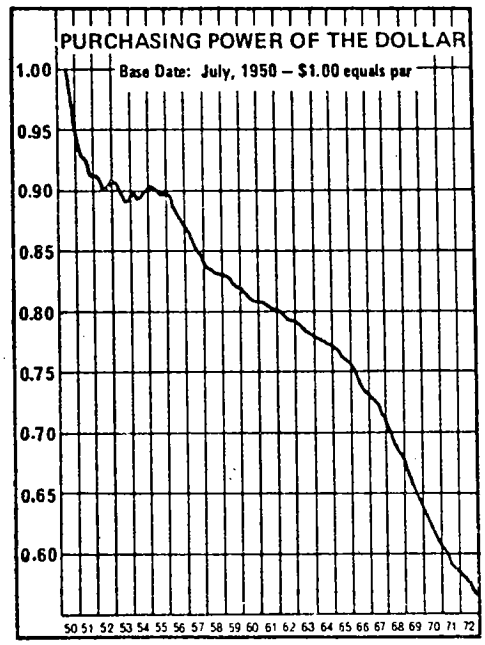
But as a decline nears its end, a different type of action occurs. Here we are apt to see selling climaxes, days in which declines heavily outnumber advances. This will produce large figures on the A-D ratio. When the total of the last 20 figures pushes the OB-OS Index into the 400 and above area on the chart, the market can be considered in an "oversold" area.

As seen on the chart, the market moved into the oversold area during early February, 1973. I noted this at the time, warning, however, that the market can stay oversold for weeks. In fact, some of the worst bear market declines have occurred during periods in which the OB-OS Index is deep in oversold territory (shown by the upper black areas on the chart). This is exactly what occurred during February and early March as the Dow probed the lower 900 area and as the regular A-D ratio broke to its lowest level since the mid-1940's.

For a brief period during mid-March the Index dropped out of the oversold area, but during the latter part of March and early April we have again seen an oversold reading on the OB-OS Index.



Based on this study, we can ultimately expect the market to mount a rally which would at least take the Index into the overbought area on this chart. Such a rally could be violent or weak, but it should produce enough churning action near its peak to bring the Index down to around 200.



In the meantime, the oversold area on the chart is expanding from "big" to "massive." In support of the rally thesis, a glance at the Wall Street Journal chart of the Averages suggests that the Averages are in "rounding bottom" formations, with the downside momentum ebbing. This should, in time, produce the first impressive advance of 1973.

GOLD: Two things seem interminable on this side of the Atlantic, the deterioration of the dollar's value and the impotency of any Administration or Government agency to confront the situation. In his last speech President Nixon mustered all the forces of counter-inflation and — put a ceiling on the price of meat (except at the farm level). This politically pleasant act is tantamount to shooting a BB at a fighting bull.

Meanwhile, it is indicated that there is now $100 billion of "hot money" overseas, much of it representing the reserves of our creditors. During the two recent US devaluations, our trading partners lost $15 billion, and so it would seem probable that they must be hatching up some emergency plans for avoiding any further such disasters.

THE DOLLAR'S BAD DEBTS

Europe's top finance officials are not saying it out loud, but they are steeling themselves for one move to solve the world monetary problem that would be political dynamite. This would be to cancel tens of billions of dollars in debts that the U.S. Treasury now owes European, Japanese and other central banks. The only alternative—as Washington has pointed out—is to give the U.S. a perpetual surplus in its dealings with foreigners that could be used to pay off these obligations. Finance officials in Holland, Belgium, Italy and Germany indicate they will sooner or later have to cancel some of the debts to implement what one of them calls sardonically the "ARP"—or "American Recovery Program."

As a point of interest, I noticed this little squib from Newsweek a few weeks ago. Th item, to put it mildly, is utterly fantastic, and I think it must have been planted by Under-Secretary of the Treasury Volcker or the Pentagon or some other such individua or institution used to dealing in wild fiction. To think that our creditors will blithely allow us to run up towering debts and then cancel those debts in despair, well, all I can say is — dream on America, dream on.

In view of all this, I was particularly interested in receiving the new Alden Wells Quarterly (Box 401, Exeter, NH 03833), which included an article by the brilliant Douglas E. Johnston. In this article, Johnston outlines the steps he thinks will occur as our creditors move to protect themselves against further loss of their (dollar) reserves and as they seek to convert the current "floating mess" into a workable monetary system.

I will outline the steps in abbreviated form (1) The Central banks buy gold with their hoard of dollars until gold reaches perhaps $150 per ounce. Or, they allow their citizens to buy gold — the effect is the same.
(2) Europe and Japan announce a new currency (the "Europa") with a gold base, the currency to be used for settling all debts. The new currency will be fully convertible into gold at the new high price for gold.
(3) The US dollar is isolated as the new currency becomes the premium currency of the world. Russia may join with a convertible ruble, and the Arabs welcome the Europa, since it is based on gold, not depreciating paper promises.
(4) The US is invited to join by making the dollar convertible at the new high gold price. If the US refuses, our creditors use their mountain of dollars to buy up US assets, thereby trading unwanted paper for tangible US assets. Johnston states that in the face of this program, the US will be expected to abandon its absurd $42.22 per ounce gold stance (the price at which the US will not sell gold), and join the hard currency nations.

An item which would seem to fit into the foregoing discussion very nicely: (1) As of April 1, 1973, all Japanese citizens and corporations were allowed to purchase up to approximately $3,000 in gold. With Japan's new wealth, with its millions of newly affluent workers, this could constitute a strong, new upward pressure on the gold price. It could also set off pressure on the part of other nations to extend the gold-ownership privilege.

Second item: I noted in the last Letter that on-balance-volume in American South African hit a new high. Two days later the stock boosted the dividend to $1 and announced a two-for-one split. I feel that the management is preparing for the coming "big boom" in gold shares. ASA is the only South African gold vehicle available on the NYSE.

Third item: On April 5 the US senate OK'd an amendment tied to the Administration's devaluation bill which would legalize gold ownership in this country. Will Congress approve, will the President veto? I don't know, but remember, legalizing gold

ownership was part of the Republican Campaign platform. What happens if gold is legalized? Very simple, millions of American's buy it as a hedge against inflation, and the price goes higher.

Item four: Tycoon Howard Hughes is well known (to say the least) for making right moves in business. Over the last ten years he has invested $18 million in 2,700 gold mining claims in the state of Nevada (from UPI, April 5, 1971).

I thought this squib from Reuters ("Economic X-Ray") was interesting: "Washington politicians and economists recently reckoned that $700 million of official gold sales would suffice to knock back the free price. On average, world reserves of inconvertible dollars have risen by far more than that amount every month for the past three months. According to American oil experts, dollar accruals to the Middle East and African oil producing nations alone may soon exceed that amount every month. Many of the oil producers have a traditional liking for gold."

As I see it, the picture is clear. The dollar flood is continuing to build throughout Europe, Japan, Asia and Africa. With two devaluations already having occurred within 14 months, holders of dollars are nervous indeed. With no signs of an official policy of halting inflation in the US, that nervousness could turn to panic at any time. Even US citizens are finally becoming aware of the dollar's demise (their pitiful response, "freeze prices and boost our wages.")

The store of value is gold. The more dollars printed, the greater the paper hoard in terms of existing gold. Yet the US Government is still thinking in terms of manipulation, in terms of selling some gold to "knock down the free market price." Unbelievable, to think that the Government sees the gold situation in terms of rigged markets and speculative raids. The rise in gold, the coming boom in gold, has nothing to do with manipulation and speculative profits. It is a direct result of the dollar's collapsing value, it is a result of thirty years of continuing profligacy on the part of Uncle Sam.

From all directions, I am asked, "Do you think the Congress will pass the US gold legalization legislation? And if so, do you think the President will veto it?" The answer, I simply cannot out outguess this one. But here is an idea of my own. The Japanese are now allowed to own $3,000 worth of gold per citizen. A few weeks later, the Senate introduces a bill giving US citizens the right of gold ownership. Is this part of a planned campaign? Suppose it has been "secretly agreed" to allow Japanese and US gold ownership? Suppose our leaders have said, "OK, we'll let John Doe buy gold. They'll rush to buy, and hedge buying and hoarding will send the price to say $150 or $200 or whatever. Then we can say, 'All right, the market says gold is worth $175 an ounce. The US Government for the first time in 40 years is going to be realistic about gold. We are going to make the dollar convertible at the market price. Your Government is going to take the first realistic stand on gold in modern history.' " Could that be in the cards? I wonder.

Gold-ownership plan backed by U.S. Senate

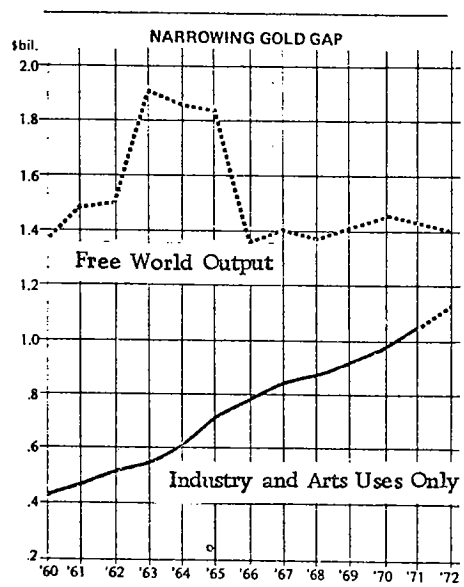
Washington

Americans can't yet buy, sell, or horde gold, but they were a step closer to being able to Thursday.

The Senate, after an emotional debate, said yes, gold ownership should be allowed, going against administration desires. But the House must still act on the plan which is tacked on to a measure officially devaluing the dollar. There is concern that gold ownership could upset the delicate monetary situation.

Meanwhile in Ottawa, a member of the Canadian Parliament, John Diefenbaker, announced that some Americans are making terrific profits by melting down Canadian coins and selling the silver across the border. He said the practice has reached the racket stage.

But even aside from all these possibilities, there is the simple problem of gold supply and demand on the industrial and art fronts. I include a chart (courtesy of Holt Advisory, 305 Madison Ave., NYC 10017), which tells the story better than I could. The two lines should meet around the mid-1970's. At that time, aside from all monetary considerations, all newly mined gold will be taken off the market for industrial-art purposes.



So that's the gold picture as I see it. You can look at it that way or you can view it the way our Government has, as a flash-in-the-pan phenomenon brought on by the gnomes of Zurich or some other fantasy land. But if I am correct, then what lies ahead is a primary gold move of extraordinary proportions. I do not like to picture it as a "fat, profitable move for stock market speculators." I view it as an unfortunate, pathetic result of political stupidity, and one which all readers should hedge against — by purchasing shares in assorted, producing gold mines.

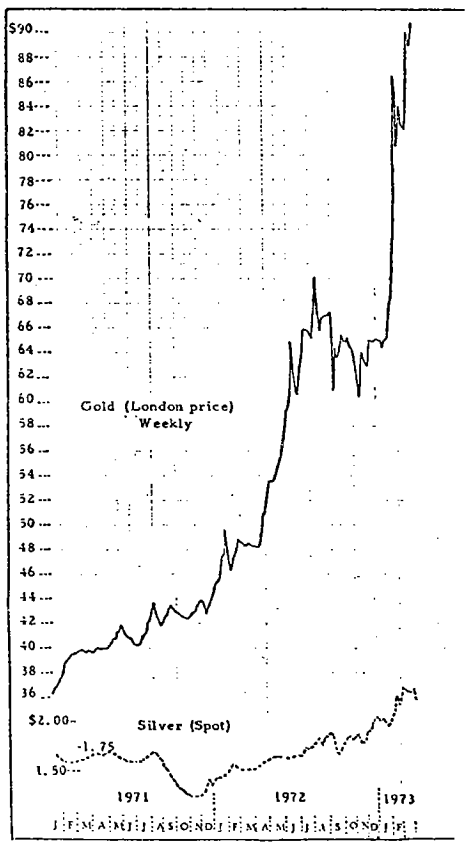
STOCKS: The reading on my technical charts of the 30 Dow stocks is down to a new low of 24. The only "good" reading I have is Allied Chemical with a 4. The SEC has ceased issuing odd-lot statistics on individual stocks, so I now have a technical scale of 0 to 5 instead of 0 to 6. Superior relative strength readings are

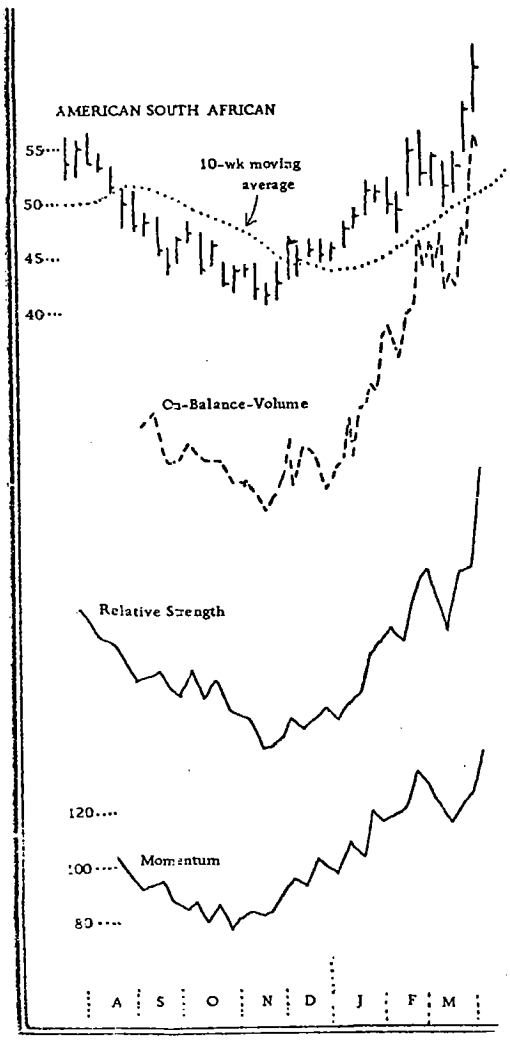
showing on Bethlehem Steel, US Steel, Exxon and Standard of California. Anaconda, a stock which has looked good all year, has failed recently on all technical counts.

I am including a point & figure chart of General Motors, a market bellwether (chart courtesy of Chartcraft, Larchmont, NY 10538). I had warned in a previous report (Letter 558) that if GM touches 71 it will turn the chart very bearish. This happened last week when GM broke temporarily under 71. GM has now formed a major top, and I would expect the stock to probe the low 60's before the year is out.

The weekly gold-silver chart shows gold at its new all-time high of $91 (second London fixing, April 8). Since most of the good 1972 earnings reports for gold shares were established with average gold prices received at under $60, the new gold price of 1973 should produce some absolutely whopping earnings.

American South African, recommended here repeatedly, is now probing the mid-60 price range. As seen on the chart, everything is checking out for this stock. On-balance-volume continues to go to new highs for the year. Relative strength is outstanding. Momentum is at 140, and this, of course, cannot continue. Remember, the momentum is the ratio of the current price of the stock against its price of 13 weeks ago (the way I compute it), and as long as momentum is above 100 it means that the stock is moving up on a 13-week basis.





LATE NOTES: One place trouble could come from in today's wild economic picture is the banking sector. The banks are very extended, and this is putting pressure on interest rates. The big variable could be confidence or lack of it on the part of foreign investors. Any large withdrawal of cash could now cripple the US banking system, sending interest rates through the roof. One acute student of money flow, Mr. T.J. Holt, writes in his latest report, that the "economy is about to experience the most devastating credit crunch in decades..." I'm not ready to argue with him.